IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

No. 18,206

TRENNIS K. LILE,

Petitioner

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent

Petition for Review of Order of the
Securities and Exchange Commission

BRIEF FOR THE RESPONDENT

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NATURE OF THE PROCEEDING

Petitioner, Trennis K. Lile, is seeking review pursuant to Section 25(a) of the Securities Exchange Act of 1934, 15 U.S.C. 78y(a), of an order of the Securities and Exchange Commission entered under Sections 15(b) and 15A of the Act, 15 U.S.C. 78o(b) and 78o-3. The Commission's order (R. 6455) [1/] revoked the registration of J. Logan & Co. ("the company") as a broker and dealer in securities, expelled the company from membership in the National Association of Securities Dealers, Inc., and found that certain persons, including petitioner who was a salesman for the company, were each a cause of the revocation and expulsion. In its Findings and Opinion (R. 6441-6454) the Commission

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1/ "R.___" refers to the record on review, and "Br.___" refers to petitioner's brief.

held that the company, together with or aided and abetted by certain of its officers and salesmen, had willfully violated the antifraud provisions of Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a), of Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b) and 78o(c)(1), and of Rules 10b-5 and 15c1-2 thereunder, 17 CFR 240.10b-5 and 240.15c1-2. Petitioner seeks to have this Court set aside the Commission's order as to him [2/] or, in the alternative, to remand the case to the Commission for the taking of additional evidence in his defense.

COMMISSION'S MOTION TO DISMISS PETITION FOR REVIEW

When the petition for review was filed in this Court, the Commission moved to dismiss it on the grounds (1) that this Court lacks jurisdiction because petitioner did not file the petition within the statutory 60-day filing period and (2) that petitioner, by his failure to file exceptions to the hearing examiner's recommended decision, did not exhaust his administrative remedies. Following argument on the Commission's motion before a panel consisting of Judges Chambers, Pope and Barnes and the subsequent filing of supplemental briefs at the Court's request, the Court on January 31, 1963, ordered that further consideration of the Commission's motion be postponed until the argument and submission of the case on the merits.

2/ A petition for review filed by another person who was named as a cause in the Commission's order is pending before this Court in Hersh v. Securities and Exchange Commission, No. 18,190.

Although the Commission still urges that the petition for review be dismissed, we will not repeat in this brief our arguments in support of the motion to dismiss. Instead, we refer the Court to our Memorandum of Points and Authorities in Support of Respondent's Motion to Dismiss Petition for Review and to our Supplemental Memorandum in Support of Motion to Dismiss Petition for Review.

STATUTES AND RULES INVOLVED

[This section, except for the final paragraph, is identical to the corresponding section of our brief in Hersh v. Securities and Exchange Commission, No. 18,190, filed herewith.]

Pertinent provisions of the relevant statutes and rules thereunder are set forth in the Appendix hereto (pp. la et seq., infra).

The Securities Exchange Act of 1934, as part of federal legislation for the protection of investors, was enacted, as set forth in its preamble:

> "To provide for the regulation of securities exchanges and of over-the-counter markets . . . [and] to prevent inequitable and unfair practices on such exchanges and markets. . . ."

To carry out this purpose, the Act provides a comprehensive scheme of registration and regulation of national securities exchanges and their members as well as for the registration and regulation of brokers and dealers doing business through interstate media otherwise than on a national securities exchange, i.e., the so-called over-the-counter market.

Section 15(a) of the Act prohibits any broker or dealer from using the mails or any means or instrumentalities of interstate commerce to effect transactions in securities without prior registration with the Commission pursuant to Section 15(b) of the Act (except for certain exemptions not involved here).

Section 15(b) requires the denial or revocation of such registration if the Commission finds, after notice and opportunity for hearing, that such denial or revocation is in the public interest and that a broker or dealer, or a person controlled by it, has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, or rules thereunder. 3/

Section 15A of the Securities Exchange Act provides for cooperative self-regulation of the over-the-counter securities industry through registration with the Commission of national securities associations composed of brokers and dealers in securities. The National Association of Securities Dealers, Inc., is thus far the only association registered under Section 15A. Section 15A(l)(2) authorizes the Commission, after notice and opportunity for hearing, to expel from a registered securities association any member thereof who the Commission finds has violated any provision of the Securities Act, the Securities Exchange Act, or rules thereunder, if such action appears to the Commission to be necessary or appropriate in the public interest or for the protection of investors or to carry out the

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3/ This Court reviewed an order denying registration under Section 15(b) in Pierce v. Securities and Exchange Commission, 239 F. 2d 160 (1956).

purposes of Section 15A.[4/]

Both the Securities Act and the Securities Exchange Act contain specific antifraud provisions. Section 17(a) of the Securities Act and Section 10(b) of the Securities Exchange Act, as implemented by Rule 10b-5 under the latter provision, make unlawful the use of the mails or interstate facilities by any person in connection with the offer or sale of any security by means of a device, scheme or artifice to defraud, an untrue or misleading statement of a material fact, any act, practice or course of business which operates or would operate as a fraud or deceit upon any person, or by means of any other manipulative or deceptive device. Section 15(c)(1) of the Securities Exchange Act specifically prohibits such conduct by brokers or dealers and authorizes the Commission, by regulations, to define such devices as are manipulative, deceptive, or otherwise fraudulent.

Section 15A(b)(4) of the Securities Exchange Act, pursuant to which the finding was made that petitioner was a "cause" of the order of revocation and expulsion, operates to prevent any broker or dealer who employs such a

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4/ Under Section 15A(b)(8) such an association may also expel or otherwise discipline its members. In Samuel B. Franklin & Co. v. Securities and Exchange Commission, 290 F. 2d 719 (1961), certiorari denied, 368 U.S. 889 (1961), this Court reviewed an order of the Commission affirming disciplinary action by the National Association of Securities Dealers against one of its members.

person from being admitted to or continued in membership in the National Association of Securities Dealers, Inc., or any other such registered association, unless the Commission otherwise gives its approval or direction in cases where it is deemed appropriate in the public interest. 5/

Section 25(a) of the Act, which grants jurisdiction to the Courts of Appeals to review Commission orders, provides that the Commission's findings of fact shall be conclusive if supported by substantial evidence.

This section also authorizes the Court, on application by either party, to order additional evidence to be taken before the Commission upon a showing to the satisfaction of the Court that such additional evidence is material and that there were reasonable grounds for failure to adduce it in the hearing before the Commission.

QUESTIONS PRESENTED

1. Whether the Commission's finding that petitioner willfully

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/ Although the finding that petitioner was a "cause" of the revocation and expulsion operates only to preclude his employment by a member of a registered securities association, the Commission's finding that he willfully violated the antifraud provisions may affect his right to employment with any registered broker-dealer, including those who are not members of a registered securities association. See Section 15(b) of the Securities Exchange Act, supra.

violated the antifraud provisions of the Securities Act and the Securities Exchange Act is supported by substantial evidence.

2. Whether petitioner has failed to show that there were reasonable grounds for his failure to adduce additional evidence in the hearing before the Commission.

STATEMENT OF THE CASE

The Commission found that J. Logan & Co., together with or aided and abetted by various persons including petitioner, willfully violated the antifraud provisions of the federal securities laws by inducing customers who were inexperienced in securities matters to place trust and confidence in the company and its salesmen and to rely on them to act in the customers' best interests, and then engaging in acts and practices contrary to the financial welfare and investment aims of the customers in order to generate income for themselves. In violation of the trust and confidence of their customers, they induced excessive trading in customers' accounts, advised customers to sell securities while simultaneously advising other customers to purchase the same securities, effected transactions without prior authorization, and made various misrepresentations.

The Company's Method of Operation

A description of the method of operation employed by J. Logan & Co. is essential to a proper understanding and appraisal of the significance of the part played by Lile in the overall enterprise. For the convenience of the Court, we will summarize those aspects of the company's method of

operation that are pertinent to the issues raised on this appeal. A more detailed description can be found in the Commission's Findings and Opinion (R. 6441-6454).[6/]

The company's policy was to maintain a large sales force, consisting of men with no prior experience in the securities business who concentrated on telephone solicitation of unknown persons. Novice salesmen were given a portion of a local street number telephone directory from which each man was instructed to call if possible 100 to 125 numbers per day. The salesmen were told that in view of their lack of experience, they would be less likely to demonstrate their ignorance in telephone calls.

In their sales solicitations, the salesmen placed great emphasis on the company's so-called extensive and highly-skilled research department, although in fact the company maintained no research department worthy of the name.[7/]

Through the technique of indiscriminate telephone calls, the company obtained a clientele of impressionable, naive, and unsophisticated investors who thereafter were urged to place their trust and confidence in the

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6/ With one possible exception (see p. 36, infra) petitioner does not challenge the Commission's findings concerning the company's method of operation. Accordingly, we have in general omitted record references in describing the company's business.

7/ For a description of the limited research facilities that the company actually had, see footnote 2 of the Commission's Findings and Opinion (R. 6443).

salesmen and to rely on them to act in the customers' best interests. Taking advantage of the trust and confidence thus induced, and in complete disregard of the financial welfare of the customers, the company and its salesmen followed a practice designed to achieve a large volume of trading, without consideration of the quality of the securities involved or the needs of the investors, and frequently resulting in substantial losses to the customers. 8/

Various techniques and practices were employed to achieve this objective:

Salesmen were organized into groups or teams, and competition among such groups as well as among individual salesmen was fostered by bulletins listing the relative standings of the salesmen and the groups, and by occasional awarding of cash prizes to those making the best showings in sales.

8/ As a former salesman testified: "Over and over again we were told as part of the indoctrination at J. Logan & Company that the only reason we were there was to make money, and we were told more often than we were told to the contrary that it didn't make any difference whether we made money for the customers or not. Our job was to make money for ourselves . . . . [T]he emphasis was on making money through trading and selling no matter what we sold rather than on selling a good stock. . . ." (R. 3604, 3606). Another salesman testified they were told "that securities should be traded as often as necessary in order for the obvious reason of more commissions resulting from this" (R. 687).

Salesmen frequently were successful in obtaining a list or even physical possession of securities already held by new customers. Such customers were invariably advised that all of their holdings were unsuitable for them and that they should liquidate their entire portfolios, including high grade investment securities, and invest in other securities, frequently of a highly speculative nature, recommended by the salesmen.[9/] Thereafter customers were persuaded to make frequent additional purchases, either through the investment of other funds or through the liquidation of securities previously acquired on the recommendations of the salesmen. In some instances the same security was bought and sold numerous times in the account of a single customer, all on the recommendation of one or another salesman.

When, as frequently happened, a salesman left the firm, the customers' account cards of the departing salesman were distributed among remaining salesmen, who were instructed to call the customers immediately and, by convincing them to sell the securities in their portfolios and reinvest in other securities, persuade them to remain as clients of the firm rather than of the former salesman. This was accomplished by pointing out the errors and bad judgment of the former salesman or by implying that he had been fired for improper conduct or had left under a cloud. The

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9/ The salesmen were advised by the company of "the advantages of certain types of securities and the ease with which they are sold to clientele, the more speculative securities as an example" (R. 691).

salesmen were instructed to use "fair means or foul" to make certain that the former salesman did not take his accounts away with him. On one occasion cash prizes were given to the salesmen who were most successful in weaning away the customers of a former salesman by persuading such customers to reinvest in other securities.

Still other techniques used to induce excessive trading in customers' accounts were the practice of effecting transactions without the customer's prior authorization or without prior consultation with the customer and the practice of simultaneously recommending the purchase of a security to one customer while persuading another to sell the same security, without disclosing the contradictory recommendations to either customer. This "switching" or cross-trading of securities back and forth between customers provided a fruitful source of mark-up income without incurring the risk and expense of maintaining inventories.

Petitioner's Activities as a Salesman for the Company

The record shows that petitioner was an active participant in the company's fraudulent scheme. The testimony relates to his dealings with customers Olive Sands, Jean Reynolds, Margo Hulbush, John T. Sinette, Jr., and Hertha Hauhart.

Olive Sands: Miss Sands received a telephone call from Lile in April 1958 (R. 193-94). At that time she owned stock which she had inherited from her father (R. 195, 236-37). She had no experience in trading in securities, had engaged in only one securities transaction in the preceding three or four years, had never worked for a living (she had been

with her father until his death), and always depended on the advice of her brother (R. 209, 236-37). After inquiring whether she owned any securities, Lile recommended that she sell the stock that she owned and purchase another security; he told her that the change would be to her advantage (R. 195). She replied that she knew nothing about stocks and would not change her investment without consulting her brother (R. 196). When she later informed Lile that her brother had advised her not to make the change (R. 204), Lile urged her to disregard her brother's advice and emphasized that the transactions would be profitable for her (R. 205). Although she at no time agreed to the recommended change (R. 204, 211), Lile nevertheless effected the transactions without her knowledge and then sent her the confirmation slips for the sale and purchase (R. 205, 207, 233, 5000, 5002). Thereafter, in an attempt to induce her to approve the unauthorized transactions, Lile again urged her to disregard her brother's advice and told her that her brother would not oppose the transactions if he had her interests at heart (R. 209, 222). When Lile then stated that she would have to pay a $60 fee if she rejected the transactions, she told him to telephone her brother (R. 227-28). Still attempting to obtain approval of the transactions, Lile called her brother, asked him why he would not agree to the transactions, and said that he (the brother) knew nothing about stocks and that J. Logan & Co. had an $800,000 research budget

and was well-informed (R. 242-44, 248).[10/] Subsequently Lile cancelled the transactions (R. 228, 237-38).

Jean Reynolds and Margo Hulbush: These customers will be considered together, since their accounts were subjected to a series of cross-trading transactions.

When Lile first telephoned Mrs. Reynolds in 1956, she owned shares of stock in several well-known companies (R. 3269, 3271). Her only prior dealings with a brokerage firm had been the transaction approximately four to five years earlier in which she had purchased those shares with funds that she had received as a gift from her father (R. 3278). She visited Lile at his office, and in response to his inquiry she disclosed her securities holdings (R. 3269-70, 3289), whereupon Lile recommended that she sell her securities and purchase others (R. 3273). In less than two months' time — from August 31, 1956,to October 26, 1956 — all her securities were sold for $56,668 (R. 3273, 3310-11, 5247-54), and during the entire period of 14 months that she had an account with J. Logan & Co. a total of 96 transactions were effected in her account, all of them upon Lile's recommendation (R. 3275, 3319-20). Lile's explanation to her as to how he was earning income from handling her account was that if she made money he would

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10/ Petitioner's assertion (Br. 21) that Miss Sands' brother was "somewhat confused" about the misrepresentation concerning the research budget is contrary to the evidence. Mr. Sands repeatedly testified, both on direct and cross-examination, that he was certain about the figure of $800,000 for research (R. 244, 246-47). He also testified that although he had some difficulty with his hearing, he could hear better over the telephone than in person (R. 247).

also make money (R. 3287). She advised Lile on many occasions that she did not understand her account, but Lile replied that he was handling it for her and assured her that she should not worry, that it was his job to worry about the account (R. 3288).11/

Mrs. Margo Hulbush started doing business with Lile in the fall of 1956 (R. 3144). At the very beginning she told him that she did not have the funds necessary to be a trader or to engage in speculative transactions (R. 3152).

Lile induced a series of four "switches" of securities between the Reynolds and Hulbush accounts. Two of the switches occurred on December 26, 1956, and the remaining two occurred on July 10, 1957, as

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11/ On cross-examination Mrs. Reynolds was questioned about one of the securities that she purchased on Lile's recommendation (R. 3324-25):

"Q. Did you know it was speculation at the time you bought it?

"A. No, I didn't know.

"Q. What would you have expected it to be when you buy a stock that sells for around forty or fifty cents a share, would you expect it to be a high-grade —

* * *

"A. Well, I would assume it was. I was under the impression that I was going to have what I had left saved."

follows:

(1) December 26, 1956 - 100 shares of Landers, Frary & Clark

Sold by Reynolds at 17-3/4

Bought by Hulbush at 19-1/4

(2) December 26, 1956 - 100 shares of Aircraft Radio Corp.

Sold by Hulbush at 18-3/4

Bought by Reynolds at 20-1/8

(3) July 10, 1957 - 50 shares of Dravo Corp.

Sold by Reynolds at 68

Bought by Hulbush at 73

(4) July 10, 1957 - 50 shares of Belmont Iron Works

Sold by Hulbush at 41-1/2

Bought by Reynolds at 45-1/8

All these transactions were confirmed by the company as principal rather than as agent for either customer; i.e., the company purchased the security from one customer and resold it to the other customer, taking the difference between the buying and the selling prices as its profit. All these purchases and sales were made upon Lile's recommendation without disclosure to either customer that he was making contrary recommendations to the other, and in at least three of the four transactions the securities that were sold had originally been acquired by the customers upon Lile's recommendation (R. 3145-60, 3275-87, 5238-41, 5255-59). In their dealings with Lile, these customers were advised by him that his recommendations were designed to bring them a better profit or to prevent a loss (R. 3148, 3156, 3308).

John T. Sinette, Jr.: This customer started trading with J. Logan & Co. following a telephone call in May 1957 from a salesman named Wagner (R. 308-09). Sinette, who was 49 years old at the time of the hearing, had engaged in about twelve securities transactions in his entire lifetime (R. 310). He did not know the difference between a principal and an agency transaction (R. 318), and although he occasionally subscribed to certain financial publications, he did not do much reading in the financial field (R. 343-44). After making two purchases through Wagner (R. 317-18), Sinette received a telephone call in January 1958 from Lile, who said that Wagner was no longer with the firm (R. 318-20). Sinette told Lile that he had been displeased with Wagner's high-pressure salesmanship and with one of the securities that Wagner had sold him (R. 320, 330-31). Lile replied that Wagner should have informed Sinette of the highly speculative nature of the security, and he apologized for Wagner's "misrepresentation" (R. 320). He then recommended that Sinette sell his securities and purchase others (R. 322). He said that he wanted to make amends for Wagner's misconduct and that in order to prove his good faith, he would effect the sales without charging the usual fees (R. 320, 323). Thereafter most of Sinette's securities were sold by Lile for $4714 (R. 326-27, 5009-16). When Sinette received the confirmations, he noticed charges for commissions on some of them (R. 334). These charges were later cancelled when Sinette complained (R. 334, 339).

Hertha Hauhart: This customer, a widow, started trading with J. Logan & Co. in January 1957 through a salesman named Sarafian (R. 1267, 1271). Although she had previously traded in the grain market for about

three years (R. 1323), she had no experience in the stock market and had never owned a security (R. 1300, 1324). Sarafian told her that it is foolish to keep money in a savings account, that he wanted to make money for her, that the company had earned millions of dollars, that it could make money only if its customers made money, that it had an extensive and competent research department, and that she should trust him and have confidence in him (R. 1268-69, 1272, 1276-77, 1291, 1296). After three transactions had been effected in her account, including an unauthorized purchase which was later cancelled when she complained, she received a telephone call in May 1957 from Lile, who told her that Sarafian was out of town (R. 1281, 1288, 1291-94, 1297). Lile urged her to buy a certain stock on the advice that an announcement would appear in the newspapers the following week and that the stock would rise thereafter (R. 1297). She did not agree to buy (R. 1298). About fifteen minutes later she telephoned the company and was connected with Sarafian, who told her that her purchase of the recommended security had been confirmed immediately (R. 1299-1300, 1353). She was so surprised at finding Sarafian in town after Lile had said that he was away that she agreed to the purchase (R. 1300, 1328-29). Subsequently, she discovered that the transaction covered warrants rather than stock (R. 1302-03, 1334-35). Lile had not told her that he was recommending warrants, and at the time of the purchase she did not even know what warrants were (R. 1302, 1330-31).

The Administrative Proceeding

The administrative proceeding here involved was instituted by the Commission on June 30, 1958. Pursuant to Rule 6(a) of the Commission's Rules of Practice, 17 CFR 201.6(a) (then Rule III(a), 22 Fed. Reg. 10442 (1957)), petitioner received a copy of the order for proceedings and notice of hearing together with a letter from the Secretary of the Commission advising him that the Commission's findings in the proceeding might be binding on him and that he was entitled to participate as a party (R. 5948-4, 5962; Affdt.).[12/]

On April 7, 1959, the second day of the hearing, petitioner was present in the hearing room. The hearing examiner, after ascertaining that petitioner was not represented by counsel, advised him that he was entitled to have an attorney represent him (R. 197, 206). In response to petitioner's assertion that he thought the proceeding was not directed against him personally but only against the company, the hearing examiner pointed out that petitioner had been named in the order for proceedings and that the charges, if proved, would affect his right to future employ-

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1/ "Affdt." refers to an affidavit executed by Ernest L. Dessecker, Records and Service Officer of the Commission, and filed in this Court in support of the Commission's motion to dismiss the petition for review (see p. 2, supra).

ment (R. 206).[13] Petitioner cross-examined two of the Commission's witnesses that day and another on the following day (R. 230-34, 247, 366-68).

13/ The following colloquy occurred (R. 206):

"Hearing Examiner: You know you have a right to counsel, of course?

"Mr. Lile: Yes.

"Hearing Examiner: You know you have the right to have an attorney here to protect your interests?

"Mr. Lile: Well, I didn't know this was against me, I thought this was against J. Logan and Company.

"Hearing Examiner: You knew you were named in the Order?

"Mr. Lile: That is why I am here.

"Hearing Examiner: Then you know that could affect your interests?

"Mr. Lile: Well, it has for the past nine months.

"Hearing Examiner: It would affect your right to employment with other companies.

"Mr. Lile: Yes.

"Hearing Examiner: If the findings should be against you.

"Mr. Lile: If it is fair for that to go through and the truth comes out, fine."

The hearing was later recessed. Thereafter on September 25, 1959, petitioner was notified that the hearing would be reconvened on October 15, 1959, and he was requested to arrange to be in daily attendance (R. 6037-38). By letter of October 7, 1959, he was requested to be prepared to go forward with his defense at the reconvened hearing. 14/

On August 31, 1960, following the close of the hearing, petitioner was notified of the scheduled dates for the filing of proposed findings and briefs, hearing examiner's recommended decision, and exceptions to the recommended decision (R. 6168-69; Affdt.). He was again notified when the Commission on October 3, 1960, extended the time for these filings (R. 6245; Affdt.). On October 11, 1960, at petitioner's request, the Commission granted a further extension, authorizing him to file proposed findings and a brief by October 24, 1960 (R. 6246-48). He did not avail himself of that extension (Affdt.). Instead, on October 28, 1960, Alexander Googooian, an attorney representing petitioner, sent a telegram to the Commission requesting either that the record be reopened for the receipt of testimony in petitioner's defense or that petitioner be granted the right to present defensive matter by way of affidavits and proposed findings. In support of this request it was asserted that at the time of the hearing James Logan, president of the company, had told petitioner that the individual salesmen such as petitioner were not involved in that proceeding and that hearings would be held at a later time with respect to them. It was further

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14/ See pp. 2608-11 of the transcript of testimony, set forth in the Appendix hereto (pp. 5a-8a, infra).

asserted that Mr. Logan, although having stated to petitioner that he would notify him of any witness who might testify concerning him, had failed to notify him of two witnesses who had so testified (R. 6293). The Commission, on December 5, 1960, ruled on petitioner's request, concluding that he had had full and adequate opportunity to present evidence in his defense and that sufficient showing had not been made to warrant reopening the record at that late date, after the extended time for the parties to file proposed findings and briefs had expired. Accordingly, the request to reopen the record or submit affidavits was denied. The Commission did, however, grant an extension of time to December 12, 1960, for petitioner to file proposed findings (R. 6300-01). Again, the filing was not made (Affdt.).

The hearing examiner's recommended decision was issued on April 28, 1961, and served on petitioner's counsel together with a copy of the Commission's Rules of Practice and a letter calling attention to the fact that Rule 17 provides for the filing within specified periods of time of written exceptions to the recommended decision and a brief in support of such exceptions (R. 6306-86; Affdt.). Although the hearing examiner found that petitioner had willfully violated the antifraud provisions of the Securities Act of 1933 and the Securities Exchange Act of 1934 and that he should be named a cause of any disciplinary order entered against the company (R. 6366), petitioner filed no exceptions or brief (Affdt.).

On July 9, 1962, the Commission entered the order that petitioner now seeks to have reviewed (R. 6455).

ARGUMENT

I. THE COMMISSION'S FINDING THAT PETITIONER WILLFULLY VIOLATED THE ANTIFRAUD PROVISIONS OF THE SECURITIES ACT AND THE SECURITIES EXCHANGE ACT IS SUPPORTED BY SUBSTANTIAL EVIDENCE.

The federal securities laws are the result of Congressional awareness that securities are "intricate merchandise." H. R. Rep. No. 85, 73d Cong., 1st Sess. (1933), p. 8. Their enactment followed a Presidential message urging that there be added to the ancient rule of caveat emptor the further doctrine of "let the seller also beware." Id. at p. 2. In Archer v. Securities and Exchange Commission, 133 F. 2d 795, 803 (C.A. 8, 1943), certiorari denied, 319 U.S. 767 (1943), the court, in affirming a Commission order revoking a broker-dealer registration, stated:

> "The business of trading in securities is one in which opportunities for dishonesty are of constant recurrence and ever present. It engages acute, active minds, trained to quick apprehension, decision and action. The Congress has seen fit to regulate this business. Though such regulation must be done in strict subordination to constitutional and lawful safeguards of individual rights, it is to be enforced notwithstanding the frauds to be suppressed may take on more subtle and involved forms than those in which dishonesty manifests itself in cruder and less specialized activities."

Because "the securities field, by its nature, requires specialized and

unique legal treatment,"[15] broad meaning is given to the concept of fraud under the federal securities laws, and the antifraud provisions of these laws are not limited to common law concepts. Norris & Hirshberg, Inc. v. Securities and Exchange Commission, 177 F. 2d 228, 233 (C.A. D.C., 1949); Charles Hughes & Co., Inc. v. Securities and Exchange Commission, 139 F. 2d 434, 437 (C.A. 2, 1943), certiorari denied, 321 U. S. 786 (1944); Los Angeles Trust Deed & Mortgage Exchange v. Securities and Exchange Commission, 264 F. 2d 199, 210 (C.A. 9, 1959).

In applying the antifraud provisions to the activities of brokers and dealers in securities, the Commission has on numerous occasions held that a broker or dealer impliedly represents that he will deal fairly with the public.[16] In its opinion in the case of Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6846, July 11, 1962, CCH Fed. Sec. L. Rep. ¶ 76,853, at 81,166, which was recently affirmed by the Court of Appeals for the Second Circuit, sub nom Berko v. Securities and Exchange Commission, 316 F. 2d 137 (1963),[17] the Commission discussed the history and application of this principle:

15/ Arleen Hughes v. Securities and Exchange Commission, 174 F. 2d 969, 975 (C.A. D.C., 1949).

16/ See 3 Loss, Securities Regulation 1482-93 (2d ed. 1961).

17/ This is not the same Berko opinion that petitioner cites (Br. 14, 15, 23), although both opinions relate to the same administrative proceeding. Petitioner cites Berko v. Securities and Exchange Commission, 297 F. 2d 116 (C.A. 2, 1961), and the companion case of Kahn v. Securities

(continued)

"Early in the administration of the federal securities laws, we held that basic to the relationship between a broker or dealer and his customers is the representation that the latter will be dealt with fairly in accordance with the standards of the profession. The failure of a broker or dealer to disclose that his conduct does not meet such standards operates as a fraud on customers. The Court [of Appeals for the Second Circuit], in a landmark case [Charles Hughes & Co., Inc. v. Securities and Exchange Commission, 139 F. 2d 434 (1943), certiorari denied, 321 U. S. 786 (1944)], recognized this so-called 'shingle' theory and affirmed our conclusion that it was not fair dealing for a broker or dealer in securities to charge customers prices unrelated to the prevailing market price. We have also applied the shingle theory in a variety of other instances. Thus, we have recognized that without appropriate disclosure

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and Exchange Commission, 297 F. 2d 112 (C.A. 2, 1961), which were petitions for review filed by two salesmen who had been named as causes of the revocation order in Mac Robbins & Co., Inc., Securities Exchange Act Release No. 6462 (Feb. 6, 1961), supplemented, Securities Exchange Act Release No. 6498 (Mar. 16, 1961). Following a remand to the Commission pursuant to the Berko and Kahn decisions reported in 297 F. 2d, the Commission issued a new opinion reaffirming its original order. Berko again petitioned for review, and the subsequent opinion of the Second Circuit affirming the Commission's order is the one that we have cited in the text.

it is a fraudulent practice to sell securities at a market price which is materially affected by artificial restrictions and stimulations caused by the seller's own activities, to sell oil royalties at prices unrelated to the reasonable value of estimated oil recoverable from the underlying tract, to execute transactions not authorized by the customer, to sell securities that are subject to a lien, to fail to execute orders or deliver securities promptly, or to accept customers' funds while insolvent." [Footnotes omitted.]

The antifraud provisions and the broker-dealer's obligation of fair dealing take on added significance and apply with special force where there is a disparity in degree of knowledge of market conditions as between the dealer and customer or where an element of trust and confidence is present. In Charles Hughes & Co., Inc. v. Securities and Exchange Commission, supra, the court noted, 139 F. 2d at 437, that "the essential objective of securities legislation is to protect those who do not know market conditions from the overreachings of those who do," and stated:

"Even considering petitioner as a principal in a simple vendor-purchaser transaction . . . it was still under a special duty, in view of its expert knowledge and proffered advice, not to take advantage of its customers' ignorance of market conditions. The key to the success of all of petitioner's dealings was the confidence in itself which it managed to instill in the customers." [Emphasis supplied.]

As the court stated in Earll v. Picken, 113 F. 2d 150, 156 (C.A. D.C., 1940):

> "He who would deal at arm's length must stand at arm's length. And he must do so openly as an adversary, not disguised as confidant and protector."

When a broker-dealer places himself in a position of trust and confidence with his customer, he thereby becomes a fiduciary and is subject to the obligations and responsibilities of a fiduciary.[18/]

With this background, we turn to the specific abuses involved in the present case -- the "churning" of customers' accounts and the cross-trading or switching of securities from one account to another. J. Logan & Co. and its salesmen induced their customers to place trust and confidence in them and to rely on them to act in the customers' best interests. Then, in order to generate profits for themselves and in complete disregard of the customers' financial welfare or investment aims they induced frequent and excessive transactions (commonly known as "churning" of accounts) and often recommended the purchase of a security to one customer while simultaneously persuading another customer to sell the same security, without disclosing the contradictory recommendations to either customer.

These practices have been condemned by the Commission in a number of opinions;[19/] and in the leading case of Norris & Hirshberg, Inc. v.

18/ See 3 Loss, Securities Regulation 1500-08 (2d ed. 1961).

19/ E. H. Rollins & Sons, Inc., 18 S.E.C. 347, 380-82 (1945)(excessive trading); Norris & Hirshberg, Inc., 21 S.E.C. 865, 886, 890-94 (1946), aff'd sub nom. Norris & Hirshberg, Inc. v. Securities and Exchange

(continued)

Securities and Exchange Commission, 177 F. 2d 228, 232 (1949), the Court of Appeals for the District of Columbia, in affirming a revocation order based upon such practices, described the churning and cross-trading activities there involved and then stated:

> "All this occurred. . . while the trusting clients were all convinced that petitioner was acting for them and in their best interest. We cannot visualize any circumstances to which the statutory phrase 'manipulative, deceptive, or other fraudulent device or contrivance' applies more aptly than the present one." 20/

Petitioner does not dispute the Commission's finding that J. Logan & Co. and its other salesmen engaged in a fraudulent scheme in violation of the federal securities laws. His argument is that the evidence does not show either that he knowingly participated in the scheme or that he otherwise violated the antifraud provisions. As we will later demonstrate, the

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Commission, 177 F.2d 228 (C.A. D.C., 1949)(excessive trading and cross-trading); Behel, Johnsen & Co., 26 S.E.C. 163 (1947) (excessive trading); Walter S. Grubbs, 28 S.E.C. 323, 328-30 (1948)(excessive trading); R. H. Johnson & Co., 36 S.E.C. 467 (1955), aff'd per curiam sub nom. R. H. Johnson & Co. v. Securities and Exchange Commission, 231 F. 2d 523 (C.A. D.C., 1956), cert. denied, 352 U.S. 844 (1956) (excessive trading); Looper and Co., 38 S.E.C. 294 (1958)(excessive trading and cross-trading); Reynolds & Co., 39 S.E.C. 902, 905-07 (1960) (excessive trading).

20/ See also R. H. Johnson & Co. v. Securities and Exchange Commission, (continued)

evidence shows that petitioner was fully aware of what the company and the other salesmen were doing and that, with such knowledge, he aided and abetted their fraudulent operation. The Court need not reach that issue, however, because entirely apart from what the others did petitioner's own conduct was, by itself, violative of the antifraud provisions.

Through his telephone solicitations petitioner sought customers like Miss Sands and Mrs. Reynolds who had little or no experience in securities trading and urged them to rely upon him to act in their best interests. He falsely represented that the company had an $800,000 research budget. Upon ascertaining what securities his customers owned, he recommended that they dispose of their holdings and reinvest in other securities. On his recommendation, Mrs. Reynolds in less than two months' time disposed of her entire $57,000 portfolio, including shares of stock in a number of well-known companies. In a little over a year, 96 transactions were effected in her account. He falsely represented that if he made money, he would make money too. He effected an unauthorized transaction for Miss Sands. In his dealings with Sinette, he accused a former salesman of having made a misrepresentation and then urged Sinette to dispose of his holdings and purchase other securities. He offered to sell Sinette's securities without charge and then deducted commissions on some of the sales. He assisted another salesman in pressuring Mrs. Hauhart to make a purchase, without disclosing to her that she was

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supra note 19. Cf. R. H. Johnson & Co. v. Securities and Exchange Commission, 198 F. 2d 690 (C.A. 2, 1952), certiorari denied, 344 U. S. 855 (1952), affirming R. H. Johnson & Co., 33 S.E.C. 180 (1952).

buying warrants rather than shares of stock. Particularly flagrant was his action in inducing four cross-trades between the Reynolds and Hulbush accounts by simultaneously making opposite recommendations to each of these customers.

Even if each thing that petitioner did is viewed in isolation from his overall course of conduct, he can hardly be considered innocent. Thus, to cite a few examples, his misrepresentation about the company's research budget was plainly fraudulent, without regard to anything else he did. So, too, was his statement to Mrs. Reynolds that he would make money if she made money.[21/] And the execution of an unauthorized transaction for Miss Sands was a violation of the implied representation that he would execute only such transactions on behalf of customers as are authorized. See First Anchorage Corp., 34 S.E.C. 299, 304 (1952).

But serious as these violations are - and we do not wish to minimize their importance - they were merely part of a course of conduct which represented a deliberate plan by petitioner to violate the trust and confidence of his customers. The fallacy that permeates petitioner's entire argument is his attempt to isolate each thing that he did from his overall pattern of conduct. His argument is not a novel one. Indeed, it has been rejected by the courts repeatedly, even in criminal cases.

21/ See United States v. Ross, CCH Fed. Sec. L. Rep. ¶ 91,251, at 94,132 (C.A. 2, July 5, 1963), where the court observed that a similar statement was "plainly" fraudulent under the Securities Act as well as under earlier statutes.

Thus, in affirming a conviction under the mail fraud statute for engaging in the fraudulent sale of securities, the Court of Appeals for the Fourth Circuit stated in Aiken v. United States, 108 F. 2d 182, 183 (1939):

> "Fraudulent intent, as a mental element of crime, (it has been observed) is too often difficult to prove by direct and convincing evidence. In many cases it must be inferred from a series of seemingly isolated acts and instances which have been rather aptly designated as badges of fraud. When these are sufficiently numerous they may in their totality properly justify an inference of a fraudulent intent; and this is true even though each act or instance, standing by itself, may seem rather unimportant. Analogies are always dangerous but sometimes rather helpful. So the old analogy of the rope seems in order: any single strand may easily be pulled apart, but many weak strands combined into a single rope may have such tensile strength as to resist the efforts even of a giant to tear it asunder. . . ."[22/]

22/ Similarly, another court said, in a case involving, inter alia, a violation of the Securities Act antifraud provisions: "Acts innocent in themselves may yet in combination constitute a fraud or attempts to commit fraud." Holmes v. United States, 134 F. 2d 125, 134 (C.A. 8, 1943), certiorari denied, 319 U. S. 776 (1943). See also Wager v. Hall, 83 U. S. (16 Wall.) 584, 601-02 (1872);

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Petitioner's overall course of conduct clearly evinced a design to induce trading in complete disregard of his customers' best interests and in violation of his fiduciary obligations to persons who had been induced to place their trust and confidence in him.[23/]

Castle v. Bullard, 64 U. S. (23 How.) 172, 187 (1859); Walters v. United States, 256 F. 2d 840, 841 (C.A. 9, 1958), certiorari denied, 358 U. S. 833 (1958); United States v. Vandersee, 279 F. 2d 176, 179 (C.A. 3, 1960), certiorari denied, 364 U. S. 943 (1961); Hunter v. Shell Oil Co., 198 F. 2d 485, 489-90 (C.A. 5, 1952); Connolly v. Gishwiller, 162 F. 2d 428, 433-34 (C.A. 7, 1947), certiorari denied, 332 U. S. 825 (1947); Nassan v. United States, 126 F. 2d 613, 615 (C.A. 4, 1942); Gates v. United States, 122 F. 2d 571, 575 (C.A. 10, 1941), certiorari denied, 314 U. S. 698 (1942); Federal Corp., 25 S.E.C. 227, 230 (1947).

23/ Cf. Stephens v. United States, 41 F. 2d 440, 445, 447 (1930), certiorari denied, 282 U. S. 880 (1930), where this Court stated:

> ". . . [A] business lawful in form and appearance does not escape the denunciation of the criminal statutes when it is commonly furthered by the use of deception and fraudulent practices.
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> * * *
>
> "If fraudulent in imporatant and continuing branches of its activities, the enterprise as a whole may properly be characterized as a fraudulent scheme."

Turning to the relationship between petitioner's conduct and the company's fraudulent method of operation, it is significant that petitioner's activity was alsmost a carbon copy of the pattern employed by the company and the other salesmen. Indeed, this similarity extended even to such details as the specific type of misrepresentation that was made concerning the research department. Thus, while petitioner represented that the company had an $800,000 research budget, another salesman told a customer that the company had a ten-man research board and still another salesman referred to the company's twenty-man research department (R. 6447, 6449). The similarity between petitioner's conduct and that of the other salesmen reinforces the conclusion that he was not acting innocently, refutes his suggestion that he had no knowledge of what the others were doing (Br. 22), and demonstrates that he played an integral and vital role in the company's fraudulent scheme. Apparently he would have this Court believe that although he was employed by J. Logan & Co. for a considerable period of time, he nevertheless worked like a hermit, was unaware of the company's policy, neither saw nor heard what the other salesmen were doing, did not know that they were abusing the trust and confidence of their customers, and by sheer coincidence just happened to follow the same modus operandi that the company encouraged and that the other salesmen used but, unlike the others, did so with innocent intent. The inference is inescapable that petitioner knew precisely what was going on and that when he adopted the same pattern of conduct which the firm and the other salesmen followed, he did so with the same fraudulent

motive.[24/]

That petitioner may have played a lesser role in the fraudulent scheme than some of the others does not absolve him from liability. Even minor participants in fraudulent securities operations have been held liable, both in civil and in criminal proceedings. In Berko v. Securities and Exchange Commission, 316 F. 2d 137 (C.A. 2, 1963), a salesman was held to be a cause of the revocation of the registration of a broker-dealer for whom he had worked only six months.[25/] In holding that an employee may not justifiably rely on sales literature furnished by an employer who is engaged in a fraudulent sales campaign, the court observed that such a salesman must be held to "a higher duty to prospective

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24/ See Walters v. United States, 256 F. 2d 840 (C.A. 9, 1958), certiorari denied, 358 U. S. 833 (1958), involving a conviction for engaging in a scheme to defraud in violation of the Securities Act. In commenting on the sufficiency of the evidence to prove criminal intent, this Court pointed out (p. 841) that "good faith is an operation of the mind of the individual and can be proven only by inference." The Court then stated (p. 842): "The existence of a uniform pattern of misrepresentation used by all defendants is patent."

25/ Lile,on the other hand, was employed by J. Logan & Co. at least from August 1956 to June 1958 (R. 237-38, 5248).

ustomers than a salesman working out of a legitimate sales operation." 16 F. 2d at 142. In United States v. Ross, CCH Fed. Sec. L. Rep. 91,251 at 94,131 (C.A. 2, July 5, 1963), a salesman who had been mployed for seven days by a broker-dealer engaged in a fraudulent sales peration was held criminally liable on the basis of a telephone call hat he had made five days after starting work. Judge Friendly commented hat the five days should have sufficed to teach "anyone" exactly what as going on. See also Van Riper v. United States, 13 F. 2d 961, 965, 66 (C.A. 2, 1926), certiorari denied, 273 U. S. 702 (1926), where Judge earned Hand pointed out that minor participants in a stock selling cheme might be convicted of mail fraud and conspiracy. It is well ettled that when persons are associated in an unlawful enterprise, the ct of one is deemed to be the act of all. Coplin v. United States, 3 F. 2d 652, 660-61 (C.A. 9, 1937), certiorari denied, 301 U. S. 703 1937). Petitioner "joined the enterprise, and was a part of the scheme. t was not necessary that he participate to the same extent as each of ie other . . . [participants]." Gates v. United States, 122 F. 2d 571, 79 (C.A. 10, 1941), certiorari denied, 314 U. S. 698 (1942).

Petitioner contends that the acts of the other salesmen are not dmissible against him (Br. 22). It is not entirely clear what the asis of his objection is, although he does assert that no conspiracy was oved. It was proved, however, and also found, that petitioner partic- ated in a fraudulent scheme (R. 6450), and as this Court said in Robinson United States, 33 F. 2d 238, 240 (1929), "a scheme to defraud, when ared in by several, becomes a conspiracy, and, if a conspiracy exists fact, the rules of evidence are the same as where a conspiracy is

charged." See also Coplin v. United States, 88 F. 2d 652, 660-61 (C.A. 9, 1937), certiorari denied, 301 U. S. 703 (1937). A similar objection was also considered in the recent decision in United States v. Ross, CCH Fed. Sec. L. Rep. ¶ 91,251 at 94,134 (C.A. 2, July 5, 1963), a criminal prosecution which, like the present case, involved a charge of engaging in a scheme to defraud in violation of the Securities Act. Although the defendants, two salesmen for a securities firm, were also charged with conspiracy, the conspiracy count was dismissed during the trial. On appeal it was urged that in the absence of a finding of conspiracy the trial judge improperly admitted evidence of fraudulent statements made by a fellow salesman of the defendants. These statements were made four months after one of the defendants had already terminated his employment with the securities firm involved. Writing for the court of appeals, Judge Friendly rejected both relevancy and hearsay objections. With respect to the relevancy of the disputed testimony, he said:

> ". . . [A] 'scheme' involves some connotation of planning and pattern, and it is hard to doubt that evidence showing that the conduct charged to a defendant followed a pattern of fraud similar to one that was being contemporaneously practiced by a fellow employee, or even that was followed later by another employee of the same house with respect to the same stock, has enough logical bearing to pass the test of relevancy."

Insofar as any hearsay objection was concerned, the court, after noting that the fraudulent utterances had been offered "as acts rather than as

declarations," stated:

> ". . . [W]e see no reason why the admissibility of relevant 'acts,' as distinguished from declarations, of an associate need rest on the existence of a conspiracy, since no hearsay problem is involved."

Petitioner is especially indignant over the finding that the cross-trading between the Reynolds and Hulbush accounts was in violation of the antifraud provisions (Br. 13-17). He even suggests that the finding that the company itself engaged in a practice of cross-trading is unsupported by the evidence (Br. 17-19).

Division's Exhibit 98 (R. 5535-59), a schedule of a partial sampling of the company's securities ledger for the years 1955 to 1957, shows 938 transactions — 424 sales by customers and 514 purchases by customers — in which the same securities were bought from and sold to different customers on or about the same day (R. 4263-66).[26/] Petitioner complains that the Commission investigator who compiled this schedule did not ascertain whether the company was maintaining a trading position in the securities shown thereon. We are at a loss to know what difference

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26/ Contrary to petitioner's suggestion that Exhibit 98 covers the period from 1953 to 1958, the record shows that it covers only transactions between March 1955 and May 1957 (R. 4284, 4304-05, 5535-56).

the existence of a trading position would make. The significance of Exhibit 98 lies in the fact that the company's business was generated primarily by the salesmen's recommendations rather than through unsolicited transactions (R. 2351-52, 4158-59, 4289-90, 4319, 5562). The exhibit reflects the results of the company's policy of simultaneously making conflicting recommendations to different customers, and it corroborates the testimony of a former salesman of the company relating to this practice of cross-trading. The salesman, Pierre Pambrun, testified that there was a practice of persuading one customer to sell a security on the advice that it was falling in price and at the same time persuading another customer to buy the same security on the advice that it was rising in price (R. 1950-52).[27/]

With respect to petitioner's participation in the cross-trading, the evidence shows a series of four switches of securities between the Reynolds and Hulbush accounts. Not only did all four of the switches involve the

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27/ In Norris & Hirshberg, Inc., 21 S.E.C. 865, 886 (1946), aff'd sub nom. Norris & Hirshberg, Inc. v. Securities and Exchange Commission, 177 F. 2d 228 (C.A. D.C., 1949), the Commission said: "Respondent has attempted to explain its cross-trading generally by stating that in its opinion a security might be advisable for one account at a particular time and inadvisable for another. . . . However, cross-trading was so consistent and pervasive, and such an integral part of respondent's business that we cannot help but conclude that it cross-traded for profit rather than for the general best interests of its customers."

same two customers, but the switches occurred in pairs — two on December 26, 1956, and the other two on July 10, 1957. Thus each switch was accompanied by a reverse transaction, so that the selling customer replenished her portfolio with a security which the buying customer disposed of, and the buying customer disposed of a security which the selling customer purchased. These "coincidences," when considered together with the company's practice of cross-trading and petitioner's overall course of fraudulent conduct, surely permit the inference that he induced the cross-trading for his own gain and not in the best interests of the customers.[28/]

Petitioner emphasizes that Miss Sands suffered no pecuniary loss (Br. 20), and he asserts that the transaction in Mrs. Hauhart's account was "ratified" by her (Br. 24). These factors are irrelevant. As this Court recently said, "the law appears to be well settled that . . . the government is not required to prove that anyone was defrauded or that any investor sustained loss." Farrell v. United States, ____ F. 2d ___, No. 18,241, Aug. 7, 1963, citing Bobbroff v. United States, 202 F. 2d 389 (C.A. 9, 1953). See also Llanos v. United States, 206 F. 2d 852, 855 (C.A. 9, 1953), certiorari denied, 346 U. S. 923 (1954); Berko v. Securities

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28/ Cf. Oxford Co., Inc., 21 S.E.C. 681, 690 (1946).

Petitioner states that there was no showing by the Commission that it is the practice of the trade to discuss with one customer the trading activity of another customer (Br. 16). He neglects to mention, however, that neither is it the practice of the trade to engage in cross-trading in violation of the trust and confidence of one's customers.

and Exchange Commission, 316 F. 2d 137 (C.A. 2, 1963). In the Berko opinion, it was stated, 316 F. 2d at 143:

> ". . . [W]hen the Commission's finding of 'cause' with respect to a salesman is supported by substantial evidence in the record, as it is here, the fact that the salesman's clients were not misled and indeed may even have profited from his actions is legally irrelevant. Hughes v. S.E.C., 85 U. S. App. D. C. 56, 174 F. 2d 969, 974 (1949). The Commission's duty is to enforce the remedial and preventive terms of the statute in the public interest, and not merely to police those whose plain violations have already caused demonstrable loss or injury."

While we believe that the evidence overwhelmingly supports the Commission's findings, petitioner's suggestion (Br. 12) that a standard of clear and convincing proof is applicable requires comment because of the misconception upon which it is based. Whatever the rule may be under other statutes or in other contexts, the applicable standard of review in the present case is established by Section 25(a) of the Securities Exchange Act, which provides that "the finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive." Under that standard the Commission has the responsibility both of resolving conflicts in the evidence and of drawing the necessary inferences from the evidence, and in reviewing the Commission's findings the court's function is only to determine whether they are supported by substantial evidence. Archer v. Securities and Exchange Commission, 133

F. 2d 795, 799 (C.A. 8, 1943), certiorari denied, 319 U. S. 767 (1943); Hartford Gas Co. v. Securities and Exchange Commission, 129 F. 2d 794, 796 (C.A. 2, 1942). Indeed, it has been held that under the statutory standard of review, there need not even be a fair preponderance of evidence in order to sustain the Commission's findings. Wright v. Securities and Exchange Commission, 112 F. 2d 89, 94 (C.A. 2, 1940). 29/

29/ Petitioner cites (Br. 22) Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 300 F. 2d 745 (C.A. 2, 1961), an injunctive action brought by the Commission under the antifraud provisions of the Investment Advisers Act of 1940, 15 U.S.C. 80b-6. The court, in affirming the district court's denial of a preliminary injunction, remarked that fraud must be established by clear and convincing proof. 300 F. 2d at 747. Subsequently, however, the case was heard en banc, and in a superseding opinion written by the same judge who had earlier written the panel decision, the court, although again affirming the district court's order, nevertheless made no mention of clear and convincing proof. 306 F. 2d 606 (1962). Furthermore, it should be noted that in both the panel and the en banc opinions the court was apparently of the view that the antifraud provisions of the Investment Advisers Act, unlike those of the Securities Act and the Securities Exchange Act, require proof of common law fraud, 300 F. 2d at 751 (dissenting opinion), 306 F. 2d at 610-11; and in the en banc opinion the court emphasized that it regarded the Investment Advisers Act as being narrower in scope than either of the other two Acts, 306 F. 2d at 609-10. In

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In view of petitioner's repeated references to the severe effect that the Commission's order will have upon him, it should be emphasized that the purpose of the order is not to penalize petitioner but to protect the investing public. In Pierce v. Securities and Exchange Commission, 239 F. 2d 160, 163-64 (1956), this Court said:

> "In our view, petitioner misinterprets the purpose of the broker-dealer registration law here involved. Denial of registration is not to be regarded as a penalty imposed on the broker. To the contrary, it is but a means to protect the public interest. 15 U.S.C.A. § 78o(b); Wright v. Securities and Exchange Commission, 1940, 2 Cir., 112 F. 2d 89, 94; Smolowe v. Delendo Corporation, 1940, D.C. N.Y., 36 F. Supp. 790. The Commission is given the duty to protect the public. What will protect the public must involve, of necessity, an exercise of discretionary determination. This Court ordinarily should not substitute its judgment of what would

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29/ (continued) any event, that was an appeal from a district court decision, not a petition to review a Commission order, so Section 25(a) of the Act which controls here was not involved. Certiorari has been granted, 371 U.S. 967. Cf. Ellis v. Carter, 291 F. 2d 270, 275 n. 5 (1961), where this Court commented that Rule 9(b) of the Federal Rules of Civil Procedure, which requires that averments of fraud be stated with particularity, does not apply to an action under Section 10(b) of the Securities Exchange Act, since a showing of common law fraud is not essential to establish a claim thereunder.

be appropriate under the circumstances in place of the Commission's judgment as to measures necessary to protect the public interest. Wright v. Securities and Exchange Commission, supra; cf. Shawmut Association v. Securities and Exchange Commission, 1945, 1 Cir., 146 F. 2d 791. Since the evidence substantially supports the Findings of the Commission as to violations of law by petitioner, we cannot conclude that the Commission abused its discretion in denying him registration."

It is the Commission's responsibility to supervise the operation of the securities markets, and in doing so it may bar certain persons from participating in those markets. "Serious as this personal injury may be, it is not of controlling importance as primary consideration must be given to the statutory intent to protect investors." Associated Securities Corp. v. Securities and Exchange Commission, 283 F. 2d 773, 775 (C.A. 10, 1960).

II. PETITIONER HAS FAILED TO SHOW THAT THERE WERE REASONABLE GROUNDS FOR HIS FAILURE TO ADDUCE ADDITIONAL EVIDENCE IN THE HEARING BEFORE THE COMMISSION.

Petitioner requests that this case be remanded to the Commission for the taking of additional evidence in his defense. He has failed, however, to meet the requirement of Section 25(a) of the Securities Exchange Act that he show reasonable grounds for his failure to adduce such evidence in the hearing before the Commission.[30/] Although the burden

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30/ See Southport Petroleum Co. v. National Labor Relations Board, 315 U. S. 100, 104 (1942).

of satisfying the Court of the existence of such grounds rests upon petitioner,[31] the only ground asserted by him is that he believed that the proceeding was directed exclusively against the company and not against him personally (Br. 5). Yet the record shows[32] that he was served with a copy of the order for proceedings and notice of hearing and was advised by the Secretary of the Commission that the findings in the proceeding might be binding upon him in the future. Petitioner appeared at the hearing and cross-examined three of the Commission's witnesses. In response to his assertion that he thought the proceeding was not directed against him personally but only against the company, the hearing examiner pointed out to him on the second day of the hearing that he had been named in the order for proceedings and that the charges, if proved, would affect his right to future employment. During a subsequent recess in the proceeding he was notified of the date when the hearing would be reconvened, was requested to arrange to be in daily attendance, and was specifically advised that all parties and persons named in the order for proceedings should be prepared to go forward with

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31/ National Labor Relations Board v. Jos. N. Fournier, 182 F. 2d 621, 622 (C.A. 2, 1950).

32/ We are not repeating record references to most of the factual statements in this section of the brief. Detailed references covering this same subject are in the Statement of the Case under the sub-head "The Administrative Proceeding," supra, pp. 18-21.

:heir defense at the reconvened hearing. Following the close of the
iearing, he was notified of the post-hearing filing schedule and of
i later extension of the filing dates. At his request the Commission
granted a further extension of time for filing proposed findings and
i brief. Then, on October 28, 1960 -- after the expiration of the
:xtended time for the filing of proposed findings and briefs, and
)ver two years after the institution of the proceeding -- petitioner
'equested that the record be reopened. Under these circumstances the
:ommission was certainly justified in denying the request. Indeed, any
)ther course would have further delayed an already prolonged proceeding
'hich involved the rights of numerous parties other than petitioner,
:ome of whom had requested a prompt conclusion of the proceeding on the
;round that a delay would be burdensome to them (R. 6100-01).

Moreover, the evidence that petitioner seeks to adduce before the
:ommission is, for the most part, irrelevant to the question whether he
'iolated the antifraud provisions. Basically, he contends that his
mployer advised him that churning was an ordinary and proper practice to
ngage in.[33/] This is nothing more than an assertion that he thought it was
awful to violate the trust and confidence of his customers. Obviously this
s no defense. See Arleen Hughes v. Securities and Exchange Commission,
74 F. 2d 969, 977 (C.A. D.C., 1949); Norris & Hirshberg, Inc. v. Securities

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3/ See petitioner's affidavit filed in this Court on November 7, 1962, in opposition to the Commission's motion to dismiss the petition for review.

and Exchange Commission, 177 F. 2d 228, 233 (C.A. D.C. 1949). Nor is it a defense that his misrepresentation concerning the research department was based upon information supplied by his superiors. There can be no justification for reliance on information furnished by an employer who is engaged in a fraudulent operation. See Berko v. Securities and Exchange Commission, 316 F. 2d 137, 142 (C.A. 2, 1963).

CONCLUSION

The Commission's motion to dismiss the petition for review should be granted, or, in the alternative, the order of the Commission should be affirmed.

Respectfully submitted,

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September 1963

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

_____
Attorney

APPENDIX

SECURITIES ACT OF 1933

Fraudulent Interstate Transactions

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

* * * *

SECURITIES EXCHANGE ACT OF 1934

Regulation of the Use of Manipulative and Deceptive Devices

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Over-the-Counter Markets

SECTION 15. (a) No broker or dealer (other than one whose business is exclusively intrastate) shall make use of the mails or of any means or instrumentality of interstate commerce to effect any transaction in, or to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) otherwise than on a national securities exchange, unless such broker or dealer is registered in accordance with subsection (b) of this section.

(b) A broker or dealer may be registered for the purposes of this section by filing with the Commission an application for registration, which shall contain such information in such detail as to such broker or dealer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, such broker or dealer, as the Commission may by rules and regulations require as necessary or appropriate in the public interest or for the protection of investors. Except as hereinafter provided, such registration shall become effective thirty days after the receipt of such application by the Commission or within such shorter period of time as the Commission may determine.

* * * *

The Commission shall, after appropriate notice and opportunity for hearing, by order deny registration to or revoke the registration of any broker or dealer if it finds that such denial or revocation is in the public interest and that (1) such broker or dealer whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, * * * (D) has willfully violated any provision of the Securities Act of 1933, as amended, or of this title, or of any rule or regulation thereunder.

* * * *

(c) (1) No broker or dealer shall make use of e mails or of any means or instrumentality of terstate commerce to effect any transaction in, or induce the purchase or sale of, any security ther than commercial paper, bankers' accept-ces, or commercial bills) otherwise than on a tional securities exchange, by means of any nipulative, deceptive, or other fraudulent device contrivance. The Commission shall, for the rposes of this subsection, by rules and regula-ns define such devices or contrivances as are nipulative, deceptive, or otherwise fraudulent.

* * * *

SEC. 15A. (a) Any association of brokers or alers may be registered with the Commission as national securities association pursuant to sub-ction (b), or as an affiliated securities association rsuant to subsection (d), under the terms and nditions hereinafter provided in this section, by ing with the Commission a registration state-ent in such form as the Commission may pre-ribe, ...

* * * *

(b) An applicant association shall not be regis-red as a national securities association unless it pears to the Commission that—

* * * *

(4) the rules of the association provide that, except with the approval or at the direction of the Commission in cases in which the Commission finds it appropriate in the public interest so to approve or direct, no broker or dealer shall be admitted to or continued in membership in such association, if (1) such broker or dealer, whether prior or subsequent to becoming such, or (2) any partner, officer, director, or branch manager of such broker or dealer (or any person occupying a similar status or performing similar functions), or any person directly or indirectly controlling or controlled by such broker or dealer, whether prior or subsequent to becoming such, (A) has been and is suspended or expelled from a registered securities association (whether national or affiliated) or from a national securities exchange, for violation of any rule of such association or exchange which prohibits any act or transaction constituting conduct inconsistent with just and equitable principles of trade, or requires any act the omission of which constitutes conduct inconsistent with just and equitable principles of trade, or (B) is subject to an order of the Commission denying or revoking his registration pursuant to section 15 of this title, or expelling or suspending him from membership in a registered securities association or a national securities exchange, or (C) by his conduct while employed by, acting for, or directly or indirectly controlling or controlled by, a broker or dealer, was a cause of any suspension, expulsion, or order of the character described in clause (A) or (B) which is in effect with respect to such broker or dealer;

* * * *

(l) The Commission is authorized, if such action appears to it to be necessary or appropriate in the public interest or for the protection of investors or to carry out the purposes of this section—

* * * *

(2) after appropriate notice and opportunity for hearing, by order to suspend for a period not exceeding 12 months or to expel from a registered securities association any member thereof who the Commission finds (A) has violated any provision of this title or any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was violating with respect to such transaction any provision of this title or any rule or regulation thereunder, or (B) has willfully violated any provision of the Securities Act of 1933, as amended, or of any rule or regulation thereunder, or has effected any transaction for any other person who, he had reason to believe, was willfully violating with respect to such transaction any provision of such Act or rule or regulation;

* * * *

Court Review of Orders

SECTION 25. (a) Any person aggrieved by an order issued by the Commission in a proceeding under this title to which such person is a party may obtain a review of such order in the Court of Appeals of the United States, within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall be forthwith transmitted by the clerk of the court to any member of the Commission, and thereupon the Commission shall file in the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record shall be exclusive, to affirm, modify, and enforce or set aside such order, in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If either party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the hearing before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon the hearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts, by reason of the additional evidence so taken, and it shall file such modified or new findings, which, if supported by substantial evidence, shall be conclusive, and its recommendation, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, and enforcing or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as amended (U. S. C., title 28, secs. 346 and 347).

* * * *

ENERAL RULES AND REGULATIONS
NDER THE SECURITIES EXCHANGE
CT OF 1934

Rule 10b–5. Employment of Manipulative and Deceptive Devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(1) to employ any device, scheme, or artifice to defraud,

(2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Rule 15c1–2. Fraud and Misrepresentation.

(*a*) The term "manipulative, deceptive, or other fraudulent device or contrivance," as used in section 15 (c) (1) of the Act, is hereby defined to include any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.

(*b*) The term "manipulative, deceptive, or other fraudulent device or contrivance." as used in section 15 (c) (1) of the Act, is hereby defined to include any untrue statement of a material fact and any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading, which statement or omission is made with knowledge or reasonable grounds to believe that it is untrue or misleading.

(*c*) The scope of this rule shall not be limited by any specific definitions of the term "manipulative, deceptive, or other fraudulent device or contrivance" contained in other rules adopted pursuant to section 15 (c) (1) of the Act.

EXTRACT FROM TRANSCRIPT OF TESTIMONY [1]

(2608) Examiner Ewell: All right, gentlemen.

Let the record show that the hearing is reconvened in the matter of J. Logan and Company, 721 East Union Street, Pasadena, California, in connection with proceedings under Section 15 (b) of the Securities and Exchange Act of 1934, Commission Docket Number 8-4128.

The hearing is being reconvened pursuant to a notice sent out by the Hearing Examiner, dated September 25th, 1959, directed to J. Logan and Company and to other persons named in the order for proceedings.

The hearing was recessed on or about April 30th, 1959, after a number of sessions, daily sessions, following the opening of the hearing

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1/ Pages 2608-11 of the transcript of testimony were not designated as part of the record on review. We are relying on these pages solely in connection with petitioner's application for leave to adduce additional evidence. In ruling on an application of this nature the Court may consider matters outside the record, such as affidavits. See Southport Petroleum Co. v. National Labor Relations Board, 315 U. S. 100, 103 (1942); National Labor Relations Board v. Forest Lawn Memorial Park Ass'n., 198 F. 2d 71 (C.A. 9, 1952); National Labor Relations Board v. Jos. N. Fournier, 182 F. 2d 621, 622 (C.A. 2, 1950). Accordingly, we are furnishing the Court a certified copy of pages 2608-11 of the transcript, and for the convenience of the Court and the parties we are reproducing the pertinent portions of those pages in the appendix to our brief. We assume that the affidavit of the petitioner, filed on November 7, 1962, will also be considered by the Court in

and was recessed at that time subject to the call of the Hearing Officer, and pursuant to that arrangement, as noted on the record at that time, the notice dated September 25th was sent out.

That notice read as follows:

"J. Logan & Company

721 E. Union St.

Pasadena, Calif.

Re: Proceedings under Section 15 (b) of the Securities Exchange Act, File No. 8-4128.

Gentlemen:

This is to notify you that the hearing in the (2609) above matter, which was recessed subject to the call of the hearing officer, will be reconvened on Thursday, October 15, 1959, at 10:00 a.m. in the branch office of this Commission located at 6331 Hollywood Boulevard, Los Angeles, California.

"In view of the extended adjournment all parties and participants and their counsel are requested to arrange to be in attendance at the hearing daily until all testimony to be adduced on behalf of the Division of Trading and Exchanges of the Commission has been concluded. And for your further information and guidance, it is understood that there are some fifty or more witnesses still to be heard from on behalf of said Division.

"Very truly yours,

"James G. Ewell, Hearing Examiner."

Copies of that notice were sent to Mr. Norman M. Walker, Esquire, 9606

Santa Monica Boulevard, Los Angeles, California; Howard M. Rhodes, Esquire, 902 Bay Cities Building, Santa Monica, California; David S. Robertson, Esquire, 650 South Grant Avenue, Los Angeles 17, California; and Mr. Charles R. Burr, Regional Administrator, Los Angeles Branch Office; Mr. James C. Flanagan, 9937 Ahmann Avenue, Whittier, California; Mr. Allen Sterling, 15900 Simonds Street, Grenada Hills, California; Mr. Claude S. Jameson, Jr., Vice President (2610) Trading Department, 423 Meadow Grove Street, Flintridge, California; Mrs. Mildred Baxter Logan, care of Logan and Company, 721 East Union Street, Pasadena, California; Mr. Benjamin Berk, 522 South Kelso Street, Inglewood, California; Mr. Trennis K. Lile, 1853 Meadowbrook Street, Altadena, California; Mr. Miles Hollister, 31214 Ballaird Road, Malibu, California; Mr. Carl Sarafian, 451 Martello Avenue, Pasadena, California, and Mr. Frank Niles, 8451 East Beverly, San Gabriel, California.

These notices were all sent by registered mail, return receipt request.

The return receipts will be on file in the office of the Commission in Washington.

Following this notice, the Examiner sent out another letter to the parties and persons named in the Commission's order by reason of the fact that, subsequent to sending out that letter, it came to the attention of the Examiner that the number of witnesses referred to therein, which was stated as fifty or more to be heard on behalf of the Commission, had been substantially reduced, and so the Examiner directed the following letter, dated October 7, 1959, which was sent to all of these same parties and persons mentioned above.

This letter went by air mail to the following effect.

After recital of the title of the case or the proceeding, the letter states as follows:

(2611) "Since advising you that the hearing in the above matter will be reconvened on October 15, 1959, it has come to my attention that the number of witnesses to be called by counsel for the Division of Trading and Exchange will probably be reduced substantially below the number referred to in my letter of September 25, 1959.

"For this reason, and also because of the long period of recess, it is requested that all parties and persons named in the Commission's Order for Proceedings, and their counsel, be prepared to go forward with evidence in defense of the Commission's charges immediately upon conclusion of the direct testimony in respect thereof.

"Very truly yours,

"James G. Ewell, Hearing Examiner."

I believe that the recitation of the persons whom these letters and notices were sent to constitute all of the persons named in the Commission's Order for Proceedings, and I think now they are ready to proceed with the taking of testimony.